Nos. 22277, 22277A and 22277B

IN THE UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

ESTATE OF BERNARD H. STAUFFER, BONNIE H. STAUFFER, EXECUTRIX,

Petitioner

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent

ON PETITION FOR REVIEW OF THE DECISIONS OF THE TAX COURT OF THE UNITED STATES

BRIEF FOR THE RESPONDENT

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FILED

APR 4 1968

WM B LUCK CLERK

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OPINION BELOW

The findings of fact and opinion of the Tax Court (I-R. 180-242) are reported at 48 T.C. 277.

JURISDICTION

This consolidated petition for review (I-R. 252-258) involves petitioner's liability for the federal income taxes of: Stauffer Reducing, Inc., of California for the fiscal years ending January 31, 1958 and January 31, 1959, and the eight-month period ending on September 30, 1959, in the total amount of $2,107,146.49; Stauffer Reducing, Inc. (Illinois), for the eight-month period ending September 30, 1959, in the amount of $340,822.82; and

Stauffer Reducing, Inc., of New York for the eight-month period ending September 30, 1959, in the amount of $6,943.95. On June 28, 1963, the Commissioner of Internal Revenue mailed notices of deficiencies, asserting deficiencies in those taxes. (I-R, 15-17, 48-50, 120-123.) Within ninety days thereafter, on September 23, 1963, petitioner filed petitions with the Tax Court for a redetermination of those deficiencies under the provisions of Section 6213 of the Internal Revenue Code of 1954. (I-R. 1-12, 35-46, 66-76.) The decisions of the Tax Court were entered June 14, 1967. (I-R. 243-245.) The case is brought to this Court by consolidated petitions for review filed September 5, 1967 (I-R. 252-258), within the three-month period prescribed in Section 7483 of the Internal Revenue Code of 1954. Jurisdiction is conferred on this Court by Section 7482 of that Code.

STATUTES AND REGULATIONS INVOLVED

The relevant statutes and Regulations are set out in the Appendix, infra.

QUESTIONS PRESENTED

1. Section 381(b) of the Internal Revenue Code of 1954 provides that a corporation which transfers its assets to another corporation pursuant to certain types of tax-free reorganizations must end its taxable year on the date of the transfer, and that the transferee corporation may not carry back a net operating loss for a taxable year ending after the transfer to a taxable year of the transferor corporation, "except" in the case of a reorganization as defined in Section 368(a)(1)(F), i.e. "a mere change in identity,

form, or place of organization" of the transferor corporation.

The question is whether the simultaneous merger of three separate corporations carrying on separate businesses in different areas into a newly created corporation constituted an "F" reorganization ("a mere change in identity, form, or place of organization") so as to come within the exception provision of Section 381(b) as the taxpayer contends, or solely an "A" reorganization ("a statutory merger or consolidation"), as the Tax Court unanimously held.

2. Whether the Tax Court correctly held that a refund to the new corporation of taxes paid by one of the merged corporations (Stauffer California), pursuant to an application under Code Section 6411 for tentative allowance of a carryback of the new corporation's post merger net operating loss against the pre-merger income of the merged corporation, resulted in deficiencies in the latter's taxes under Section 6211.

STATEMENT

The facts as stipulated (I-R. 152-171) were incorporated in its findings of fact by the Tax Court (I-R. 182). Its findings of fact (I-R. 182-213) may be summarized as follows:

In July 1958, Bernard H. Stauffer became the sole shareholder of three corporations engaged in the sale of a patented weight control machine. The corporations were Stauffer Reducing, Inc., of California (Stauffer California), which operated in the Western

United States; Stauffer Reducing, Inc., an Illinois corporation (Stauffer Illinois), which conducted its business in the Midwest; and Stauffer Reducing, Inc., of New York (Stauffer New York), which carried on activities in the Northeastern United States. During the latter part of 1958, Mr. Stauffer was solicited by representatives of Deming and Albuquerque, New Mexico, to relocate in those cities. It was decided to relocate in Albuquerque, and an option to purchase an industrial site nearby was acquired by Stauffer California. (I-R. 184-186, 187-188.)

In connection with the relocation, Mr. Stauffer formed a New Mexico corporation, Stauffer Laboratories, Inc. (Stauffer New Mexico), in which he was the sole stockholder. A plan of reorganization was formulated whereby the three old companies would merge into Stauffer New Mexico on October 1, 1959. In proposing the plan to the board of directors of Stauffer California, Mr. Stauffer stated that the merger was advisable (I-R. 188)--

> in view of the possibility of effecting substantial reductions in manufacturing and overhead costs through the combination of all of the facilities and operations in one central location, to the greatest extent possible, and the coordination of supervisorial activities. Further, it would be possible through the merger to bring all of the activities of the business within a single corporate body subject to the jurisdiction of the State of New Mexico, in which State most of the assets of the business would be located.

The formal merger agreement was approved by Mr. Stauffer in his capacity as sole stockholder of the four corporations and was

executed by him and his wife on September 28, 1959, in their respective capacities as president and secretary of each company. On or about September 29, 1959, Stauffer California exercised the option to acquire the site near Albuquerque at a price of $130,500. Title was taken in the name of Stauffer New Mexico by deed recorded on October 1, 1959. (I-R. 188-189, 191.)

The terms of the merger agreement were: (1) that each of the three old companies would merge with Stauffer New Mexico, the surviving corporation, pursuant to the laws relating to statutory mergers of the four states; (2) that the stated capital, paid-in surplus and retained earnings of Stauffer New Mexico would equal those of the three constituent companies; (3) that all property of the three constituent corporations would be vested in Stauffer New Mexico, which would be responsible for all liabilities and obligations of the three constituent corporations; and (4) that on the effective date of the merger the separate existence of the three constituent corporations would cease. The merger agreement further provided that it would not become effective or binding upon any of the constituent corporations, their officers or shareholders until a copy of the agreement and any other certificates or documents required by law were properly filed and recorded with the proper governmental agencies in each of the four states involved. (I-R. 189.)

The merger was effected on October 1, 1959, in accordance with the terms of the agreement. The agreement was filed with the Secretary of State of New Mexico early in the morning of that day, and was thereafter filed that same day in the appropriate agencies of the other three states (California, Illinois and New York). On issuance of additional stock of Stauffer New Mexico to Mr. Stauffer in respect of the stock of each of the constituent corporations, Mr. Stauffer remained the sole shareholder of Stauffer New Mexico. (I-R. 189, 190.)

Prior to the merger, on or about August 13, 1959, a request had been made of the Internal Revenue Service as to the tax consequences of the proposed reorganization. The Service was asked to rule that it would constitute a reorganization within the meaning of Section 368(a)(1)(A) of the 1954 Code (a statutory merger or consolidation). There was no request for any ruling as to whether the proposed merger would also qualify under Section 368(a)(1)(F) ("a mere change in identity, form, or place of organization, however effected"). On September 14, 1959, the Service ruled that the proposed merger would be a reorganization under Section 368(a)(1)(A). (I-R. 190-191.)

Because of business reversals, the contemplated Albuquerque relocation was never carried out. Stauffer New Mexico's principal place of business was in Los Angeles at what had previously been the main office of Stauffer California. Stauffer New Mexico

continued to carry on the operations previously conducted by the old companies from the same locations as before the merger. The accounting records continued to be broken down as though the three old companies were still in existence, except that no inter-company profits appeared on the books. (I-R. 191.)

Stauffer New Mexico was liquidated on January 31, 1961, and its assets, subject to its liabilities, were distributed to Mr. Stauffer, who thereafter continued the same business operations as a sole proprietor. (I-R. 192.)

Prior to the 1959 merger, the three old companies had filed separate corporate returns and had reported income on a fiscal year basis (February 1 to January 31). However, none filed closing tax returns for the period from February 1, 1959, the beginning of the new fiscal year, to September 30, 1959, the last day of their separate existence. It was originally intended that the old companies would file closing returns, as a request for an extension of the time for filing was made along with payments of taxes. (I-R. 192.)

Instead of filing closing returns for the old Stauffer companies, a return was filed in the name of Stauffer New Mexico which combined the operations of the old Stauffer companies and Stauffer New Mexico for the period February 1, 1959, to January 31, 1960. An Internal Revenue Service audit in 1960 did not contest the filing of a single return. (I-R. 192, 195.) In its closing

income tax return for the next fiscal year (ended January 31, 1961), Stauffer New Mexico reported a net operating loss of $3,366,052. And in an application for a tentative carryback adjustment, filed April 10, 1961, Stauffer New Mexico requested a refund of $1,481,653, consisting of all income taxes theretofore paid by Stauffer California for the year ended January 31, 1958, and $263,194 of the income taxes paid by Stauffer California with respect to the year ended January 31, 1959. [1/] Under Section 6411 of the 1954 Code, the Commissioner is authorized to make a refund within 90 days of such an application subject to a limited examination to determine whether omissions or errors of computation have been made. On this basis, a so-called "quickie" refund was allowed in the claimed amounts plus interest. The checks were drawn to Stauffer New Mexico, and were negotiated by Bernard H. Stauffer as trustee in dissolution and former sole shareholder of the then-dissolved New Mexico corporation. (I-R. 196, 198-199.)

Mr. Stauffer, acting as trustee in dissolution and former president and sole shareholder of Stauffer New Mexico, executed a document entitled "Transferee Agreement-Corporation" (Form 2045) on behalf of Stauffer New Mexico. Stauffer California was

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1/ The application did not, however, specifically identify Stauffer California. (I-R. 198.)

denominated as transferor and Stauffer New Mexico as transferee in this document. It read in part as follows (I-R. 200):

> In consideration of the Commissioner of Internal Revenue not issuing a statutory notice of deficiency to and making an assessment against the above-named transferor corporation, the undersigned admits that it is the transferee of assets received from said transferor corporation, and assumes and agrees to pay the amount of any and all Federal income, excess-profits, or profits taxes finally determined or adjudged as due and payable by the above-named transferor corporation for the taxable year (or years) ended 1/31/58 and 1/31/59, to the extent of its liability at law or in equity, as a transferee within the meaning of Section 6901 of the Internal Revenue Code of 1954 and corresponding provisions of prior internal revenue laws; * * *

The Commissioner determined deficiencies against the three old companies based on their failure to file closing returns for the eight-month period prior to the merger, and against Stauffer California based on disallowance of the carryback of the net operating loss of Stauffer New Mexico. The notices of deficiency were sent to Mr. Stauffer as the ultimate transferee of the assets of the three old companies. As Mr. Stauffer died shortly after the issuance of the notices of deficiency, his estate, the petitioner here, instituted suits in the Tax Court for a redetermination. Petitioner conceded the liability of Mr. Stauffer as transferee of the three old companies. (I-R. 182-183.)

The Tax Court, in a reviewed decision (per Judge Raum), unanimously rejected petitioner's claim that the merger of the old Stauffer companies into Stauffer New Mexico was a reorganization within

the meaning of Section 368(a)(1)(F) of the 1954 Code. Consequently, under Section 381(b) of the Code, the old Stauffer companies were required to file closing returns and no carryback of Stauffer New Mexico's net operating loss was allowable to offset the pre-merger income of the old companies. (I-R. 35-55.) Petitioner alternatively contended that, if the merger did not qualify as an "F" reorganization, no deficiency arose in Stauffer California's income taxes as a result of the net operating loss carrybacks. Petitioner's view rested on the ground that Stauffer New Mexico is to be regarded as a stranger to Stauffer California; hence, there was an erroneous refund of Stauffer California's taxes for which only Stauffer New Mexico is liable. Judge Raum held, to the contrary, that Stauffer New Mexico, as the successor of Stauffer California, had standing to claim the refund of Stauffer California's taxes, and therefore a deficiency did arise in the tax liability of Stauffer California. (I-R. 239-242.) 2/

2/ A second alternative issue raised by petitioner in the Tax Court, concerning a write-down of inventory (I-R. 235-239), has been abandoned in this Court.

SUMMARY OF ARGUMENT

I

While Congress has accorded nonrecognition of gain or loss treatment to all corporate "reorganizations" as defined in subparagraphs A to F of Section 368(a)(1) of the 1954 Code, it has expressly declined to treat all reorganizations alike for other tax purposes. In Section 381 it set out in detail the extent to which the "acquiring corporation" in certain tax-free "reorganizations" (those defined in Section 368(a)(1)(A), (C), (D), and (F)) may "succeed to and take into account" specified tax "items" of the transferor corporation. Section 381(a) sets forth the general rule, "subject to the conditions and limitations specified in subsections (b) and (c)". Subsection (c) lists the particular items to which the general rule applies (e.g. net operating loss carryovers, earnings and profits, methods of accounting, inventories, depreciation allowances). Subsection (b), captioned "Operating Rules", contains additional limitations: it requires that the taxable year of the transferor corporation shall end on the date of the transfer (Section 381(b)(1)), and it precludes the acquiring corporation from carrying back a net operating loss for a taxable year ending after the reorganization transfer to a taxable year of the transferor corporation (Section 381(b)(3)), "except in the case of an acquisition in connection with a reorganization described in subparagraph (F) of Section 368(a)(1)". Section 368(a)(1) in turn defines an "F" reorganization as "a mere change in identity, form, or place of organization, however effected."

Accordingly, under the express terms of Section 381, the taxable year of the transferor corporation terminates, and a net operating loss carryback privilege otherwise available to a corporation under Section 172 is not available, even in the case of a tax-free reorganization, unless the reorganization qualifies as an "F" type.

In this case, three separate corporations (Stauffer California, Stauffer Illinois, and Stauffer New York), carrying on separate businesses in different geographical areas, were simultaneously merged under the applicable state laws into a new corporation (Stauffer New Mexico), having the same sole stockholder as its predecessors, and the separate businesses formerly carried on by the several merged transferor corporations were combined and thereafter conducted as one by the transferee corporation. In a unanimous and carefully reasoned opinion sustaining the Commissioner's determination, the Tax Court held that the merger constituted an "A" reorganization only ("a statutory merger or consolidation"), not an "F" reorganization ("a mere change in identity, form, or place of organization"), and therefore did not come within the exception provision of Section 381(b). In so holding, the Tax Court reached the only conclusion compatible with the terms and history of Section 381, the terms and history of the reorganization definitions in Section 368(a), the inter-relationship of those sections and other sections of the Code, the applicable Treasury Regulations, and the relevant decisions.

The reason for the statutory exception in Section 381(b) in favor of "F" reorganizations is apparent from the very statutory

description of that kind of reorganization as compared with other kinds (subparagraphs A through E of Section 368(a)(1)). The definition of an "F" reorganization--"a mere change in identity, form or place of organization"--is stricter than that of other types; it is limited to mere formalistic changes in the charter or place of organization of a single corporate enterprise, such as reincorporation in another state, and does not encompass an amalgamation of multiple operating corporations. In the few instances in which the "F" reorganization definition was applied up to the time of its inclusion in the 1954 Code, it was applied to the reincorporation of a single corporate enterprise, and it was in that setting that Congress re-enacted the definition in Section 368 and incorporated it by reference in Section 381. In harmony with the legislative history of Section 381 (S. Rep. No. 1622, 83d Cong., 2d Sess., pp. 275-277) and the more rigorous definitional requirements of an "F" reorganization, the long standing Treasury Regulations provide that only in the case of a reorganization qualifying under subparagraph F of Section 368(a)(1), i.e. only where there is a "mere" formalistic change in a single corporate enterprise, will the "acquiring corporation" be treated for purposes of Section 381(b) "just as the transferor corporation would have been treated if there had been no reorganization". Regulations Section 1.381(b)-1(a)(2). And it is abundantly clear from the examples given in the explanatory Senate Finance Committee Report and the Treasury Regulations that a merger or consolidation of two or more operating companies constitutes an "A" reorganization, not an "F" reorganization, for purposes of applying the exception

provision of Section 381(b). S. Rep. No. 1622, supra, p. 276; Regulations Section 1.381(c)(1)-1(b).

Unless the Congressional distinction between an "F" vis-a-vis an "A" reorganization is to be obliterated, an "F" reorganization is necessarily limited to the reorganization of a single corporation, and does not embrace a fusion of two or more operating corporations. Wherever the demarcation line between an "A" and an "F" reorganization is to be drawn, it is plain that an amalgamation of two or more corporate ventures into a single corporate enterprise is more than an "F" reorganization ("a mere change in identity, form, or place of organization"), and falls on the "A" side of the line ("a statutory merger or consolidation"). While the merger of a single corporation into a newly created one (reincorporation) may qualify as both an "A" and "F" reorganization, the merger or consolidation of two or more existing corporations cannot. To hold otherwise would for all practical purposes erase any meaningful difference between an "A" and an "F" reorganization, upon which the applicability of Section 381(b) expressly hinges, and nullify the exception provision of that section. Indeed, before consummating the reorganization here in question the parties to the merger sought and obtained from the Internal Revenue Service a ruling to the effect that the transaction would constitute an "A" reorganization; it was not until after the new corporation had sustained substantial post-merger operating losses that the parties sought to treat the transaction as an "F" reorganization and escape the mandate of Section 381(b).

The taxpayer does not and cannot point to any authority which warrants, much less demands, reversal of the unanimous decision below. The only authority which may be considered contrary to the Tax Court's decision here is a prior unreviewed decision of the Tax Court itself (Pridemark, Inc., 42 T.C. 510, reversed on other grounds, 345 F. 2d 35 (C.A. 4th)), and that decision has been properly (and unanimously) overruled by that court's later and more thoroughly reasoned opinion in this case. As for Davant (43 T.C. 540, modified 366 F. 2d 874 (C.A. 5th), upon which taxpayer also relies, the Tax Court there held that the transaction constituted a "D" reorganization, and the Fifth Circuit's alternative holding that it also constituted an "F" reorganization was unneccessary to its decision.

Equally without merit is taxpayer's alternative contention that the merger transaction should be split up into its component parts and viewed as if only one of the three merged corporation (Stauffer California) had been reincorporated (as Stauffer New Mexico), so as to constitute "a mere change in identity, form, or place of organization" of Stauffer California alone. The record shows, as the Tax Court took pains to point out, that the merger of the three Stauffer corporations into Stauffer New Mexico was carried out contemporaneously pursuant to a unitary plan, each merger being dependent on the others. Viewed as a single integrated planned transaction, as the Tax Court properly held it should be, the arrangement constituted an "A" and not an "F" reorganization.

II

The Tax Court also correctly held that the Commissioner was not precluded from determining deficiencies against Stauffer California for its taxable years ending prior to the merger (fiscal years 1958 and 1959) by reason of having made a "quickie" refund of its taxes for those years to Stauffer New Mexico, based on the erroneous carryback of Stauffer New Mexico's post-merger operating loss against the pre-merger income of Stauffer California. The refund was claimed by and made to Stauffer New Mexico, successor to Stauffer California, under the "tentative carryback adjustment" provisions of Code Section 6411. The Tax Court having correctly held that the merger did not qualify as an "F" reorganization and that therefore Section 381(b) prohibited the carryback (Point I, *supra*), it was likewise correct in holding that the tentative refund resulted in deficiencies in Stauffer California's pre-merger income taxes under Code Section 6211, for which Stauffer New Mexico and its stockholder are admittedly liable.

ARGUMENT

I

THE SIMULTANEOUS MERGER OR CONSOLIDATION OF THE OLD STAUFFER COMPANIES INTO STAUFFER NEW MEXICO WAS NOT AN "F" REORGANIZATION

A. Introduction

Section 381 of the Internal Revenue Code of 1954, Appendix, infra,[3/] permits a corporation that acquires the assets of another corporation, through the tax-free liquidation of a subsidiary (Section 332) or through certain types of corporate reorganizations (Section 368(a)(1), Appendix, infra), to "succeed to" various tax and accounting attributes of "the distributor or transferor corporation." It also imposes limitations and conditions which concern both the transferor corporation and the acquiring corporation. Two inter-related limitations are that the taxable year of the transferor corporation must end on the date of the transfer (Section 381(b)(1)), which means that the transferor corporation is to file a closing tax return at that time notwithstanding that its usual taxable year would not have ended at that time (Section 1.381(b)-1(c), Treasury Regulations on Income Tax (1954 Code), Appendix, infra);[4/] and the acquiring corporation may not carry back a post-reorganization net operating loss "to a taxable year

3/ Section references hereafter are to those of the Internal Revenue Code of 1954, unless otherwise indicated.

4/ References to Treasury Regulations hereafter are to those promulgated under the 1954 Code.

of the * * * transferor corporation." (Section 381(b)(3)). These restrictions do not apply, however, if the reorganization is one described in Section 368(a)(1)(F)--"a mere change in identity, form, or place of organization, however effected."

Petitioner claims that the merger or consolidation [5/] of the old Stauffer companies into Stauffer New Mexico was an "F" reorganization and thus falls within the exception to Section 381(b). Petitioner's basic position (Br. 31-33) is that, since continuity of ownership and business is the touchstone of the "F" reorganization, that twofold requirement was fully met because the business of each of the old companies was continued in the new company, the stock of which was owned by the same sole shareholder as the predecessor companies. However, continuity of ownership and business enterprise is, in the general sense in which petitioner uses it, true of every tax-free reorganization defined by Section 368(a)(1). Subdivisions (A) through (D), coupled with Section 354, permit various amalgamating reorganizations in which multiple corporate enterprises may be combined into one corporation. Subdivision (D) and Section 355 permit a divisive reorganization such as a "spin-off," where "a part of the assets of a corporation is transferred to a new corporation and the stock of the transferee is distributed to the shareholders of the transferor."

5/ Technically, what occurred here was a consolidation. "In a merger, one corporation absorbs the corporate enterprise of another corporation," while "Consolidations typically involve the combination of two or more corporations into a newly created entity, with the old corporations going out of existence." Bittker & Eustice, Federal Income Taxation of Corporations and Shareholders (Second ed.), p. 516.

See Commissioner v. Baan, 382 F. 2d 485, 491 (C.A. 9th), pending in the Supreme Court on grant of certiorari (October, 1967 Term, No. 781). Subdivision (E) permits a recapitalization, i.e., the "reshuffling of a capital structure, within the framework of an existing corporation." Helvering v. Southwest Consolidated Corp., 315 U.S. 194, 202. There is complete continuity of business enterprise in each of these reorganizations in that all business assets remain in corporate solution. What petitioner's argument is reduced to, then, is that the sole criterion of an "F" reorganization is identity of ownership; that an amalgamating or divisive reorganization is a "mere change in identity, form, or place of organization" if the shareholders of the new corporation are the same as the old.6/ This has been rejected by the Court of Claims as to a divisive reorganization in Columbia Gas of Maryland, Inc. v. United States, 366 F. 2d 991 (100 percent continuity of ownership in the resulting two corporations). Similarly, the converse situation here, in which identically owned

6/ Petitioner (Br. 26-28, 35-36) cites decisions such as Casco Products Corp. v. Commissioner, 49 T.C. 32, involving the reorganization of a single corporate enterprise in which redemption of a 9 percent stock interest was effectuated through a merger. The question there was whether adequate shareholder continuity of interest was maintained to qualify the merger transaction as an "F" reorganization, a question which the court deemed it unnecessary to reach on the theory that the merger and the stock redemption were functionally unrelated. See, also, Reef Corp. v. Commissioner, 368 F. 2d 125 (C.A. 5th), certiorari denied, 386 U.S. 1018, and Rev. Rul. 61-156, 1961-2 Cum. Bull. 62; compare Gallagher v. Commissioner, 39 T.C. 144, and Cabot Corp. v. United States, 220 F. Supp. 261 (Mass.), affirmed per curiam, 326 F. 2d 753 (C.A. 1st). The shareholder continuity of interest requirements for a Section 368(a)(1)(F) reorganization have been in litigation, and their precise outlines have not been determined, but these cases have no bearing on the issue here.

separate corporate enterprises are consolidated into a new corporation, requires the same result.

The Tax Court unanimously concluded that such an amalgamation is not a "mere change" in form or identity within the meaning of the "F" provision. Cf. Libson Shops, Inc. v. Koehler, 353 U.S. 382, 387-388.[7/] So doing, the court properly departed from its prior decision in Pridemark, Inc. v. Commissioner, 42 T.C. 510, reversed, 345 F. 2d 35 (C.A. 4th), and refused to follow an alternative holding in Davant v. Commissioner, 366 F. 2d 874, 884 (C.A. 5th), certiorari denied, 386 U.S. 1022. Although the Internal Revenue Service has previously taken the position that a merger of several enterprises could be an "F" reorganization, that position was reconsidered and rejected in light of its history and the provisions of the 1954 Code. The Commissioner therefore did not maintain that the merger of brother-sister corporations in Davant was an "F" reorganization on appeal to the Fifth Circuit, but argued only that it was a nondivisive "D" reorganization. The Fifth Circuit nevertheless held that the transaction was both an "F" and a "D" reorganization.[8/] As Judge Raum's opinion here points out (I-R. 232), the Solicitor General opposed certiorari in Davant on the ground that the transaction was a "D" reorganization and did not argue

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7/ The Supreme Court specifically approved Newmarket Manufacturing Co. v. United States, 233 F. 2d 493, 497 (C.A. 1st), which held under the 1939 Code that after reincorporation of a single enterprise in another state a carryback was permissible because it was the same in all respects as its predecessor except for the change in corporate domicile. The Supreme Court pointed out that the difference between amalgamating separately operated and taxed enterprises and reincorporating a single corporate enterprise "is not merely a matter of form 353 U.S., p. 388.

8/ In Davant the Tax Court held (43 T.C. 540) that the transaction was a "D" (not an "F") reorganization. The Fifth Circuit's holding that it was also an "F" reorganization was unnecessary to its decision

the applicability of Section 368(a)(1)(F). We believe that the Tax Court's unanimous decision in this case is unmistakably correct and note that it has been followed in Associated Machine v. Commissioner, 48 T.C. 318, pending on appeal to this Court (No. 22304).

B. The scheme of the reorganization provisions, and the language and history of Section 368 (a)(1)(F), indicate that the "F" provision is limited to formalistic changes in a single corporate enterprise

The scheme of Section 368(a)(1) suggests a descending order of significance, with subdivision (F) as the least consequential of any reorganization. Subdivisions (A) through (D), as noted, involve business combinations and divisions. Subdivision (E), the

structure of a single corporate enterprise. The "F" provision, like the "E", does not describe any particular type of inter-corporate transaction -- such as a statutory merger or consolidation -- but simply indicates the result that may be accomplished "however effected." That result is the very limited one of "a mere change in identity, form, or place or organization." Considered in its context, that language simply means a reincorporation (a new charter) in the same or in another state and no more. See Berghash v. Commissioner, 43 T.C. 743, 752, affirmed, 361 F. 2d 257 (C.A. 2d); cf. Newmarket Manufacturing Co. v. United States, 233 F. 2d 493, 497 (C.A. 1st). To be sure, the other categories of reorganizations are in a sense concerned with changes in identity or form, but they are not "mere" changes; and to give

the "F" provision a broad reading would be to engulf other types of reorganizations, such as the divisive "D", without assimilating their restrictions (see the highly articulated Section 355 and this Court's opinion in Commissioner v. Baan, supra). In other words, subdivisions (E) and (F) are similar in that they do not describe a transaction between corporations, but relate to an intracorporate transaction which results in a change in either the capital or the corporate structure. Thus, the "E" and "F" provisions are said to apply to "'internal' readjustments in the structure of a single corporate enterprise." Bittker & Eustice, Federal Income Taxation of Corporations and Shareholders (Second ed.), p. 507.

The historical setting in which Congress re-enacted the "F" provision into the 1954 Code confirms that understanding of its limited reach. The provision was derived without substantial change, from the Revenue Act of 1921, c. 136, 42 Stat. 227, Sec. 202(c). (See Judge Raum's opinion (I-R. 224).) In the period before adoption of the 1954 Code, it was applied where there was a reincorporation of a single corporate enterprise. 9/ E.g., San Joaquin Fruit & Inv. Co. v. Commissioner, 77 F. 2d 723, 724-725 (C.A. 9th), reversed on other grounds, 297 U.S. 496; Ahles Realty Corp. v. Commissioner, 71 F. 2d 150 (C.A. 2d), certiorari denied, 293 U.S. 611; George Whittel & Co. v. Commissioner, 34 B.T.A. 1070. In 1954, the House of Representatives recommended its

9/ Certain of these cases were decided under the Revenue Act of 1924, c. 234, 43 Stat. 253, Sec. 203(h)(1)(D), when the "mere change" provision was the "D" reorganization. As additions were made to the reorganization provisions, it became the "E" (see Helvering v. Southwest Consolidated Corp., 315 U.S. 194, 202-203) and finally the "F" in the present Code.

repeal because the minor alterations it permitted could be accomplished through other types of reorganizations. 10/ See Bittker & Eustice, supra, p. 548. Nonetheless, it apparently was retained "at the request of the tax bar, representatives of which noted that subparagraph (F) clearly covered reincorporations of all of a corporation's assets in another state or in the same state after expiration of a charter -- transactions which might not meet the other definitions of a reorganization." 11/ Columbia Gas of Maryland, Inc. v. United States, 366 F. 2d 991, 994, fn. 3 (Ct. Cl.); see 1 Senate Hearings before the Committee on Finance on the Internal Revenue Code of 1954, 83d Cong., 2d Sess., pp. 403, 539. When the present Code was enacted, it had never been thought that the "F"

10/ The "F" reorganization is generally accomplished by one of the other forms of reorganization, since no particular steps are indicated by the statute. For example, existing corporation X can merge into newly formed corporation Y through a statutory merger under Section 368(a)(1)(A) or a transfer of all its assets under Sections 368(a)(1)(D) and 354(b). Since Y started out as a shell and on the reorganization acquired all the characteristics of X, the only result is a change in the identity, form, or place of organization of X. However, the fact that a transaction which takes the form of an "A", or non-divisive "D", reorganization can amount to merely an "F" has led to some of the confusion regarding the scope of subdivision (F). The confusion results from assuming that if an "A" can be an "F", every "F" is an "A". But, of course, a true "A" -- that is, an amalgamation of separate corporate enterprises -- is not the absorption of a single corporate enterprise into a new shell and is therefore not an "F".

11/ The fears of the tax bar may have been to some extent justified because, under the law prior to the "F" provision, an exchange of stock pursuant to the reincorporation of General Motors (changing its place of organization from New Jersey to Delaware) was held to be taxable. Marr v. United States, 268 U.S. 536.

reorganization could involve multiple corporate enterprises--either the amalgamation of separately operated corporate enterprises or the division of one corporation into two or more entities. And the very narrow scope of the "F" provision was made clear in the sections of the 1954 Code which make reference to it.

C. Section 381 and its history demonstrate that (1) an "F" reorganization does not include more than a single corporate enterprise and (2) the survivor of a consolidation (here Stauffer New Mexico) may not carry back a net operating loss to a taxable year of any of its predecessors

1. Section 381(b) creates a set of mechanical rules requiring the closing of the taxable year of the transferor corporation on a tax-free reorganization (and the distributor corporation on a tax-free liquidation), and denying the acquiring corporation a carry-back to any pre-acquisition taxable year of the transferor (or distributor). Thus, in any reorganization there can be but one acquiring corporation (see Treasury Regulations, Section 1.381 (a)-1(2)(i), Appendix, infra), and that corporation alone survives as the taxpayer. If, for example, X, Y, and Z corporations consolidate into new corporation S (as in the present case), S is the acquiring corporation and will succeed to its predecessors' tax attributes (such as net operating losses) for prospective application under Section 381(c); S will not be entitled to carry back any post-consolidation net operating losses to any pre-consolidation year of its constituents. Section 381(b)(3); Treasury Regulations, Section 1.381(c)(1-1(b), Example (2), Appendix, infra. On a

statutory merger, in which case S would have been conducting its own business prior to the reorganization (see footnote 5, supra), Section 381(b) would not preclude S from carrying back to its own pre-reorganization taxable years a net operating loss arising after the merger.[12/] Treasury Regulations, Section 1.381(c)(1)-1(b), Example (1), Appendix, infra. Thus, the application of Section 381(b) and (c) hinges entirely on the acquiring corporation: It succeeds only prospectively to the tax attributes of the corporations which it acquires and fully retains its own tax attributes, if any.

Considered in this light, it can be seen why Congress excepted the "F" reorganization from Section 381(b). The reincorporation of a single enterprise in a different state would have required a closing return and loss of a possible carryback when, apart from the change of domicile, the resulting corporation would be the same taxpayer as its predecessor. So the Treasury Regulations, Section 1.381(b)-1(a)(2), Appendix, infra, provide that in an "F" reorganization "the acquiring corporation shall be treated * * * just as the transferor corporation would have been treated if there

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12/ Note, however, that a net operating loss of X or Y or Z to which S succeeded as a result of the reorganization could not be carried back to any prior taxable year of S, but could only be carried forward. Section 381(c)(a)(1)(A).

had been no reorganization." Judge Raum stated (I-R. 221), "The underlying theory of * * * [this provision] quite plainly is that there is such a complete identity between the pre- and post-reorganization enterprises in an 'F' reorganization that the acquiring corporation is to be treated exactly as the transferor corporation would have been treated in the absence of any reorganization."

The Treasury Regulations (Sections 1.381(b)-1(a)(2) and 1.381(c)(1)-1(b), Examples 1 and 2) which explain the operation of Section 381(b) in connection with a consolidation, merger, and "F" reorganization are directly traceable to the report of the Senate Finance Committee, which did the final drafting of Section 381. Three examples are given in the report which establish that the Tax Court correctly applied Section 381 in this case (S. Rep. No. 1622, 83d Cong., 2d Sess., p. 276 (3 U.S.C. Cong. & Adm. News (1954) 4621, 4914-4915):

> Paragraph (3) of subsection (b) provides that an acquiring corporation to which property is distributed or transferred in a corporate transaction described in paragraphs (1) and (2) of subsection (a) (except a reorganization described in subparagraph (F) of section 368(a)(1)) is not entitled to carry back a net operating loss for a taxable year ending after the date of distribution or transfer to a taxable year of the distributor or transferor corporation. For example, [1] assume corporations X and Y transfer on December 31, 1954, all their property to Z in a transaction described in subparagraph (A) of section 368(a)(1). <u>If Z has a net operating loss in 1955, such loss cannot be carried back to a taxable year of X or Y.</u> Or, [2] assume corporation X <u>merges</u> into corporation Y on December 31, 1954, <u>in a statutory merger</u> with

> Y's charter continuing after the merger. If Y has a net operating loss in 1955, such loss cannot be carried back to a taxable year of X but shall be a carryback to a taxable year of Y. [3] If, however, corporation X, in a reorganization described in subparagraph (F) of section 368(a)(1), merely changes its identity, form or place of organization, the resulting corporation is entitled to carry back its net operating loss to a taxable year of X prior to the reorganization. [Emphasis added.]

Example 3 in the excerpt deals with the "F" reorganization situation in regard to a single corporation; and example 2 above deals with a merger of two existing corporations in which one retains its charter and, for that reason, its own tax attributes. Example 1 concerns the situation in this case -- consolidation of existing corporations into a new corporation -- and clearly shows that there is to be no carryback to any taxable years of the constituent companies. Insofar as Section 381 deals with carrybacks, it is apparent that Congress infused into the 1954 Code the single business enterprise theory that was adopted by the Supreme Court in Libson Shops, supra, and the First Circuit in Newmarket Manufacturing Co. v. United States, 233 F. 2d 493.[13]

[13] Those decisions, of course, came down under the 1939 Code, but each made reference to the 1954 Code provisions that had already been enacted. Newmarket noted that Section 381(b) would have permitted the carryback in circumstances like those before it (the reincorporation of a single enterprise in another state). 233 F. 2d, p. 493. The Supreme Court in Libson Shops adopted that same rationale, making special reference to the Newmarket case. It cannot be assumed that these decisions failed to take account of the relevant aspects of the 1954 Code.

In short, the operation of Section 381, reinforced by the plainest legislative declarations and the Treasury Regulations, should be decisive of the principal issue here. But there are, as we will show, even further indications that Congress intended and contemplated that the "F" provision would retain its traditionally limited application to a single corporate enterprise.

2. One of the fundamental principles of Section 381 is that the acquiring corporation shall take into account the tax attributes of the transferor corporation only prospectively. Section 381(c)(1)(A) requires that the net operating losses of the transferor corporation, to which the acquiring corporation succeeds, be carried forward starting with "the first taxable year ending after the date of * * * transfer." Stated another way, the acquiring corporation may not carry back the transferor's net operating loss to any of its pre-reorganization taxable years. Read in this way, it is evident that Section 381(c)(1)(A) is a necessary counterpart to Section 381(b), which precludes a carryback of the acquiring corporation's net operating loss to a pre-reorganization taxable year of the transferor corporation. In combination, Sections 381(b) and 381(c)(1)(A) prevent the tax attributes of the acquiring corporation to be used retrospectively to change tax results of the pre-reorganization years of the transferor corporation (when it constituted a separately taxed entity), and similarly the tax attributes of the transferor corporation may not be used to alter the pre-reorganization tax results of the acquiring corporation.

Applying petitioner's notion that a reorganization which combines two or more corporate enterprises can be within the "F" provision, leads to the following anomaly: The highly restrictive Section 381(b), which denies certain advantages to all except the "F" reorganization, would not prevent a carryback of the acquiring corporation's net operating loss to a taxable year of the transferor, whereas Section 381(c)(1)(A) (which does not except the "F" reorganization) would prevent a carryback of the net operating loss of the transferor to a pre-reorganization taxable year of the acquiring corporation even in the case of "a mere change in identity, form, or place of organization" (an "F" reorganization). Plainly, if Congress had intended that the "F" provision encompass more than a single enterprise it logically would have provided the same exception in Section 381(c)(1)(A) as it provided in Section 381(b). However, the exception for the "F" reorganization in Section 381(b), again we submit, was designed to permit a carryback to a pre-reorganization year of the transferor only when the acquiring corporation is the same taxpayer as the transferor corporation and not when the acquiring corporation is an amalgamation of separately operated and taxed enterprises.

3. An "F" reorganization involving more than a single enterprise would make Section 381(b)(1) unworkable and would run counter to the most elementary principles of taxation. Assume that two of the old Stauffer companies had filed returns for different fiscal-year periods, and that the third company filed its return on a calendar year basis. Assume further that they consolidated into

Stauffer New Mexico (as here) before the end of each of their normal taxable years. Under petitioner's theory of the "F" exception to Section 381(b)(1), the taxable years of the old companies would not end. These questions arise: First, would Stauffer New Mexico have to file three returns -- one for each predecessor as its taxable year came to an end? Second, insofar as the three old companies were separately operated during the parts of their several taxable years prior to the merger, may their operations in that period be combined in a single return filed by Stauffer New Mexico? Third, assuming Stauffer New Mexico could file a single return, would it report on a fiscal year basis or a calendar year basis? If Stauffer New Mexico adopted a calendar year basis for filing its return, the effect would be either to lengthen or to shorten the normal accounting period of at least the two predecessors that had previously filed on a fiscal basis. The rationale behind Section 381(b)(1) is to eliminate these problems by one general rule requiring the transferor corporations to end their taxable years at the date of transfer and thus report their separate incomes and expenses as separate corporate taxpayers to the extent that they were separately operated for any period prior to the reorganization.

In this case, it was no more than pure happenstance that the old Stauffer companies filed returns using the same fiscal period, so that the questions that would normally arise were not immediately apparent. Nevertheless, the three old Stauffer companies filed no returns for the eight-month period when they were operated as separate taxpayers prior to their absorption by Stauffer New Mexico.

While it is true that Stauffer New Mexico filed a return at the end of the fiscal period which included these pre-reorganization operations of the old companies, the return was one "combining the operations of all the companies for the entire fiscal year." (I-R. 193.) Can the eight-month period of individual accountability of the old companies be ignored and the reorganization be given effect as if it had occurred at the beginning of the fiscal period? Section 381 permits succession to the tax attributes of predecessors, but it does not permit the surviving corporation to combine and thus revise the pre-reorganization individual accountability of the constituent companies. Apart from the filing of a consolidated return, which is not available to brother-sister corporations, it is fundamental that separate corporations must file separate returns. It is clear that Congress did not wish to undermine that rule in Section 381. Indeed, Section 381(b)(1) is indisputably designed to prevent abrogation of the usual rule.

Again, it can be seen that in excepting the "F" reorganization from Section 381(b)(1) Congress meant only to permit a single corporate enterprise to continue its regular reporting and not to permit separate corporations to combine their operations for the period prior to reorganization.

4. Section 381(a)(2) limits the carryover privilege to non-divisive "D" reorganizations (those that meet the requirements of Section 354(b)). "The section [381] does not apply * * * to divisive or other reorganizations not specified in subsection (a)." S. Rep. No. 1622, <u>supra</u>, p. 276 (3 U.S. Code Cong. & Admin.

News (1954), 4621, 4914). The "spin-off" divisive reorganization is the exact opposite of what occurred here. In its basic form it involves a distribution of all the stock of a newly-created subsidiary corporation to the shareholders of the parent corporation. See Sections 355 and 368(a)(1)(D). Hence, in that way business enterprises originally combined in a single corporation can be separated into two or more brother-sister corporations. Here, brother-sister corporations were consolidated into a single entity.

Taking the expansive view of "identity" or "form" that petitioner adopts, the division of a single corporation into brother-sister corporations cannot rationally be distinguished, for purposes of applying Section 381(b), from the amalgamation of brother-sister corporations into a single corporation.

It therefore stands to reason that, if shareholder continuity were the sole and sufficient test of an "F" reorganization, as petitioner maintains, the spin-off reorganization would come under Section 381(b) through qualification as an "F" reorganization notwithstanding Congress' intended exclusion.[14/] Neither the spin-off nor the amalgamation of brother-sister corporations is a "mere" change in the tax or business world. The separation or division of a single corporate enterprise into two or three corporations further limits the liability of their common shareholders. Each corporation files its own tax return, and each obtains a surtax

14/ There is also the problem that from 1934 to 1951, Congress did away with a provision that permitted the spin-off reorganization to be classed as a tax-free reorganization. Commissioner v. Baan, supra, p. 491. If the spin-off could have qualified as an "F" reorganization, Congress' purpose in repealing the provision would have been frustrated.

exemption under Section 11(d). From the opposite side of the coin, the amalgamation of three brother-sister corporations may increase efficiency or make credit more easily available because of the larger pool of assets in a single unit. And, of course, it will require the filing of one tax return and only one surtax exemption in lieu of three returns and three exemptions. If these represent "mere" changes of identity or form for purposes of the "F" provision, then every tax-free reorganization defined by Section 368(a)(1) is an "F" reorganization. 15/

A fair reading of Section 381, its legislative history, and the "F" provision itself requires the conclusion that an amalgamation of three separate corporate enterprises cannot be an "F" reorganization. The Fifth Circuit's alternative holding to the contrary, in Davant, was in an entirely different context than this case. Section 381 was not before the Fifth Circuit and, unfortunately, the legislative evidence presented to the Tax Court and this Court was not presented to it. We consequently urge this Court not to follow the alternative ruling in Davant. For, as Judge Raum stated (R. 230), "The Code

15/ In Addition to the irreconcilable problems relating directly to Section 381 that acceptance of petitioner's theory would create, Judge Raum's opinion (R. 228-229) notes the difficulties it would raise as to the complex Section 1244 (losses on the stock of a small business corporation). Section 1244(d)(2) is headed "Recapitalizations, changes in name, etc." and provides a special rule for an "F" reorganization -- obviously because it involves no more than a change in name or a reincorporation.

As also noted in the opinion below (R. 44), petitioner's theory of an "F" reorganization would create additional problems regarding treatment of the capital and surplus (or deficit) accounts of the old corporations.

is an extraordinarily complex and sensitive instrument, and we should be careful not to give an interpretation to one provision that would generate unintended difficulties in respect of other provisions, unless such interpretation is clearly called for by the statute itself. In the situation before us we can find no such command in the statute requiring the fusion of these three corporations to be treated as a 'mere change in identity, form, or place of organization.' To the contrary, the indications point the other way." After almost fifty years in which the "F" provision lay dormant and after Congress employed it in the 1954 Code in reliance on its highly restricted compass, it is too late in the day to enlarge it beyond its historic limits.

D. <u>There was no single "F" reorganization of Stauffer California into Stauffer New Mexico</u>

Petitioner maintains (Br. 10, 31-36, 49-51) that the merger or consolidation of all the companies into Stauffer New Mexico was either an "F" reorganization or three separate "F" reorganizations. These "alternative" contentions actually represent one argument stated in two ways, and for the reasons already outlined that argument is unsound.

It appears to us that petitioner places major emphasis on the contention that the absorption of Stauffer California by Stauffer New Mexico was alone an "F" reorganization. Petitioner's preliminary statement (Br. 18) presents four hypothetical situations, other than the one in issue, in which Stauffer California might have

been entitled to a carryback. Apart from the second illustration, involving a pure "F" reorganization in which Stauffer California by itself would have changed its place of organization to New Mexico, each of the other illustrations is dependent on a merger of Stauffer New York and Stauffer Illinois into Stauffer California [16/] in which Stauffer California -- as the acquiring corporation -- would fully retain its own corporate and tax attributes. These hypothetical situations do not support petitioner's position; indeed, they bring out the fact that the "F" reorganization claim is not its real claim here. No carryback is permissible because Stauffer California was not the acquiring corporation under Section 381; Stauffer New Mexico was the acquiring corporation, and it happened not to have any pre-existing tax attributes that would survive the reorganization. It therefore becomes evident that petitioner, in asking that Stauffer California's absorption into Stauffer New Mexico be segregated and treated as an "F" reorganization, is truly requesting a reformation of the entire transaction so that Stauffer California can take on the identity of Stauffer New Mexico and become the acquiring corporation. [17/]

16/ In situation one, the Illinois and New York companies merge into Stauffer California; in situation three, the same merger occurs and then Stauffer California changes its place of organization; and in situation four, Stauffer California first changes its place of organization to New Mexico and then the other two companies merge into it.

17/ Furthermore, it is axiomatic that tax consequences flow from what the taxpayer does, not from what it might have done. E.g. Founders General Co. v. Hoey, 300 U.S. 268, 275; Television Industries, Inc. v. Commissioner, 284 F. 2d 322, 325 (C.A. 2d); Montana Power Co. v. United States, 232 F. 2d 541, 543 (C.A. 3d).

The excerpt from the legislative history of Section 381 (quoted, supra) shows that Congress envisaged precisely what occurred here. The Senate Finance Committee Report explicitly called attention to a transaction consolidating separate corporations and expressly stated that a carryback to any pre-reorganization taxable years of the constituent companies would not be permissible. Section 381(b) simply establishes a uniform rule that gives rise both to benefits and to burdens.[18/] For example, in this case, the old Stauffer companies were required to file closing returns on the date of the transfer, but were together entitled to three surtax exemptions. Stauffer New Mexico, in starting as a new taxpayer, could have adopted an accounting period different from any of its constituents. Since it, too, was entitled to a surtax exemption, and since the reorganization occurred before the end of the fiscal years of the old companies, there were a total of four surtax exemptions within the same accounting period. There are taxpayers who attempt to arrange corporate reorganizations in such

18/ The previously quoted excerpt from the Senate Finance Committee Report also shows that in a true merger -- i.e., the absorption of the assets of one corporation (X) by another operating corporation (Y) -- the acquiring corporation (Y), its "charter" continuing after the merger, would have the right to carryback to its pre-merger taxable years a subsequently arising net operating loss. Thus, Congress fully recognized that it was creating a rule that hinged on the identity of the acquiring corporation.

a way as to increase the number of surtax exemptions, despite their giving up a carryback to pre-reorganization taxable years. See Dunlap & Associates, Inc. v. Commissioner, 47 T.C. 542. We need not speculate as to what tax considerations were in the mind of Mr. Stauffer when the old Stauffer companies were consolidated into Stauffer New Mexico, but doubtless if Stauffer New Mexico had operated profitably the four surtax exemptions would have looked much better than the possibility of a net operating loss carryback.

What is important here is that there was one transaction by which Stauffer New Mexico acquired all the assets of the old companies. No part of the whole transaction can be disengaged and accorded special consideration. Cabot Corp. v. United States, 326 F. 2d 753 (C.A. 1st), affirming per curiam, 220 F. Supp. 261 (D. Mass.).

The merger agreement, to which all four corporations were parties, specifically provided that it would not be binding or effective until approved by the shareholders of each company and the state filing requirements were met. (Ex. 7-A, paras. 8A-8F.) Stauffer New Mexico was to have capital and surplus equal to the sum of the items of the old companies on the effective date of the merger; it was to have all the property of the constituent companies upon the merger becoming effective; and the separate existence of the old companies would cease on the effective date

of the merger. (Ex. 7-A, paras. 6E-6F, 6I, 8I.) Petitioner itself points out (Br. 56) that paragraph 6E of the merger agreement defined "the effective date of the merger" as "the effective date of the last of the individual mergers." (Emphasis added.) In fact, all of the steps necessary to consummate "the merger" were carried out on October 1, 1959. (I-R. 189-190.) The Tax Court consequently found (I-R. 233-234):

> The merger agreement specifically stated that it would not be binding upon any of the constituent corporations, their officers, or stockholders until a copy of the agreement and any other certificates and documents required by law were properly filed and recorded with the proper governmental authority of all four states. Even if Stauffer California complied with the laws of its jurisdiction before Stauffer Illinois and Stauffer New York did so, a finding we cannot make on the state of this record, by the terms of the Merger Agreement there was no valid merger between any of the corporations until the laws of all of the states involved had been complied with. Thus, the three old Stauffer companies merged into Stauffer New Mexico not seriatim but simultaneously. Either all three were parties to the "F" reorganization or none were. The three mergers were interdependent. (Emphasis added.)

Moreover, what was done was also the natural means of accomplishing the stated business purposes for the reorganization. The reorganization was not intended to defer to Stuaffer California's "dominance," but to physically relocate the businesses of the three old companies in New Mexico where "it would be possible through the merger to bring all the activities of the business within a single corporate body subject to the jurisdiction of the State of New Mexico, in which state most of the assets of the business would be

located." (I-R. 188.)[19] Although subsequent business reverses did not permit the physical relocation to New Mexico, the point is that the reorganization was not merely intended to change the domicile of any one corporation. It was intended to change the domicile of all of the companies by combining them all into a "single corporate body." In addition, Judge Raum found (I-R. 217-218):

> Before consummating the reorganization in question the parties had sought and obtained from the Internal Revenue Service a ruling to the effect that the transaction would result in a tax-free reorganization as a "statutory merger or consolidation" within the meaning of subparagraph A of section 368(a)(1). It was then expected that each of the constituent companies would file closing returns, and indeed, as late as December 15, 1959, an application was filed on behalf of each of the three old Stauffer companies for an extension of time for filing returns for the period February 1 - September 30, 1959. * * * It was only later, when it became clearly apparent that the new company had sustained substantial losses during the four-month period, October 1, 1959 - January 31, 1960, that it was determined to file a single return for the full fiscal year February 1, 1959 - January 31, 1960 in the name of the new company and to include therein the profitable operations of the three old Stauffer companies for the first eight months against which the losses of the last four months were applied. In order to justify that course of action, as well as the failure to file closing returns for the three old Stauffer companies, the position was taken that the merger of the three old companies into Stauffer New Mexico was an "F" reorganization.

19/ Mr. Stauffer was describing the plan to the board of directors of Stauffer California, which was identical for all of the Stauffer companies except Stauffer New York which had one additional inactive director. (I-R. 187.) Mr. Stauffer's reference to the "business" means the three old Stauffer companies since he is speaking of a merger into a "single" corporate body.

Thus, before and even after the reorganization there was no intention to retain the tax identity of Stauffer California alone, assuming that such a mere intention unconfirmed by the nature of the reorganization itself is material. Furthermore, in filing a single return covering the pre-merger operations of the old companies, it was surely recognized that the consolidation of the three companies was one transaction that had to qualify as an "F" reorganization in toto or not at all.[20]

In the Tax Court (I-R. 232) and before this Court, petitioner (Br. 42-44) places heavy reliance on Rev. Rul. 58-422, 1958-2 Cum. Bull. 145. There (p. 146), "a corporation desired, for valid business reasons, to reincorporate in a state other than the state of its incorporation and to acquire and operate directly the assets and businesses of its two wholly-owned subsidiaries." Although the transactions were carried out simultaneously in the form of an "A" reorganization, i.e., the parent and subsidiaries merged

20/ Petitioner (Br. 28-30) discusses Dunlap & Associates, Inc. v. Commissioner, 47 T.C. 542, in which a corporation changed its domicile from New York to Delaware (by merging into a newly formed Delaware corporation) and simultaneously made a tender offer to acquire a minority interest in its subsidiaries in exchange for its own stock. The sole question was whether the issuance of stock on the tender offer sufficiently shifted the ownership to defeat an "F" reorganization. The Tax Court held that there was an "F" reorganization because the tender offer and the reorganization were separate transactions (id. at 551): "there was no assurance, at the time of the merger [i.e., the reincorporation in Delaware], that such minority interest would accept the offers. Nor was there any provision in the merger agreements that the transfer of the New York corporation's assets to petitioner would be undone if the minority stockholders were not responsive to the offers." (Emphasis added.) The Dunlap case, patently, bears no kinship to the present case. There, the issuance of stock on the tender offer was not an integral part of the reorganization.

into a newly-formed corporation, the Service ruled that there was an "F" reorganization as to the parent company and a tax-free liquidation of the subsidiaries under Section 332. Judge Raum concluded (I-R. 232-233), that that situation is distinguishable from this case "since the subsidiaries or their businesses were always under the same corporate umbrella of the parent, both before and after the reorganization." Indeed, Section 332 (complete liquidation of a subsidiary) provides at the end of its subsection (b) that "a transfer of property of * * * [the subsidiary] to the taxpayer shall not be considered as not constituting a distribution * * * in complete cancellation or redemption of all the stock of * * * [the subsidiary], merely because the carrying out of the plan involves (A) the transfer under the plan to the taxpayer by * * * [the subsidiary] of property, <u>not attributable to shares owned by the taxpayer</u>, on an exchange described in Section 361 [tax-free exchanges between parties to a reorganization], and (B) the complete cancellation or redemption under the plan, as a result of exchanges described in Section 354 [tax-free exchanges of stock and securities of corporations which are parties to a reorganization], <u>of the shares not owned by the taxpayer</u>." (Emphasis added.) What this passage means is that, if corporation A's subsidiary B transfers its property to corporation X in a tax-free reorganization in which B's shares are cancelled, the transaction is nonetheless to be treated as the complete liquidation of a subsidiary under

Section 332 and not a corporate reorganization. See Treasury Regulations, Section 1.332-2(d), (e).

It is understandable, then, that Rev. Rul. 58-422, supra, p. 146, holds that "the liquidation of the two subsidiaries in pursuance of the merger agreement are liquidations to which Section 332 applies." The ruling further explains (p. 146):

> In the instant case, the fact that the subsidiaries of the former parent were liquidated at the same time that the said parent reincorporated in a different state did not constitute a change in the stockholders or assets of the merged corporation. The stockholders of the former parent had the same equity in the surviving corporation that they had in the three old corporations, inasmuch as all of the assets of the three transferor corporations were held by the surviving corporation. In this connection, had the subsidiaries liquidated under the nontaxable provisions of section 332 of the Code before the merger and, subsequently, the parent reincorporated in a different state, the latter transaction would have been considered a reorganization coming within the provisions of section 368(a)(1)(F) of the Code. The fact that the two transactions were consummated simultaneously does not change the above conclusions. (Emphasis added.)

What the ruling says is this: First, the liquidation of the two subsidiaries is a separate transaction (under Section 332) from the reorganization of the parent. Second, since there were two transactions the mere fact that they were consummated simultaneously in time does not alter their separate individual character. Third, a comparison with a situation in which the two transactions are separated in time indicates that the liquidation of the subsidiaries

does not destroy a subsequent reincorporation of the parent. Fourth, there is no reason why the liquidation should do so when it is consummated simultaneously with an "F" reorganization. 21/

In contrast, the present case involves the amalgamation of brother-sister corporations into a newly formed corporation-- a transaction which in its entirety falls within Section 368 (a)(1)(A); it was executed in the same manner in which amalgamating "A" reorganizations are usually consummated; there was a unitary agreement in which each step was made legally inter-dependent upon the other; and there was no intention evidenced, subjectively or objectively, that Stauffer California alone should undergo an "F" reorganization and retain its tax identity.

Perhaps the best way to look at this case is to turn it around and suppose that the Commissioner were maintaining that Stauffer California had merged into Stauffer New Mexico under the "F" provision, and therefore Stauffer California should not file a closing return and Stauffer New Mexico should not thereby obtain an additional surtax exemption for the fiscal period. Would the Commissioner have even an arguable case? Petitioner would claim that the amalgamation of the three old Stauffer

21/ It is significant that the ruling did not hold that the tax-free liquidation of the subsidiaries was an "F" reorganization, even though they had a closer relationship with the parent than the three brother-sister corporations had _inter se_ in this case. Also, under Section 381(a)(1) and (b), the liquidated subsidiaries would be required to file closing returns and no carryback would be allowed to their taxable years.

companies into Stauffer New Mexico was an "A" reorganization and no part of it was an "F" -- and petitioner would be clearly right.

II

THE ERRONEOUS CARRYBACK TO STAUFFER CALIFORNIA'S TAXABLE YEARS RESULTED IN A DEFICIENCY IN ITS TAX LIABILITY FOR WHICH MR. STAUFFER BECAME LIABLE AS AN ADMITTED TRANSFEREE

The issue in this phase is whether the "quickie" refund of Stauffer California's pre-reorganization taxes, based on the erroneous carryback of Stauffer New Mexico's losses, resulted in a deficiency in Stauffer California's tax liability. 22/ See Section 6211, Appendix, _infra_. If such a deficiency did arise, Mr. Stauffer's (hence petitioner's) liability as ultimate transferee is admitted. (I-R. 183.) Petitioner's argument is that no deficiency arose in Stauffer California's taxes because (Br. 65) the rebate was made to Stauffer New Mexico, "held to be an entirely different taxpayer than Stauffer California." But petitioner agrees (Br. 65-66,67) as it must with the Tax Court's holding (I-R. 241-242) that Stauffer New Mexico as the successor of Stauffer California through an "A" reorganization had standing to claim a refund of Stauffer California's taxes. See Rev. Rul. 54-17, 1954-1 Cum. Bull. 160. Petitioner diverges (Br. 67) from the Tax Court solely on the basis that (a) Stauffer New Mexico filed the refund claim in its own name and not in the name of, or on behalf of Stauffer California and (b) Stauffer New Mexico failed to

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22/ Any deficiencies as a result of the failure of the three old Stauffer companies to file closing returns for the pre-reorganization portion of their fiscal periods are not involved in this aspect of the case; petitioner's contentions are limited to the carryback.

file proper evidence establishing its successor status, all of which were requirements of Rev. Rul. 54-17, supra.

Petitioner's position is utterly without substance. Its failure to meet the formal requirements of Rev. Rul. 54-17, supra, would have been grounds for the Commissioner to reject the refund claim, which he could waive by making a refund. See Angelus Milling Co. v. Commissioner, 325 U.S. 293. It was there asserted that the Commissioner had waived any objection to errors in a refund claim (similar to those in this case) because he had considered the claim on its merits. Although in Angellus it was held that there had been no waiver, Justice Frankfurter, writing for the Court, stated (325 U.S., p. 297):

> If the Commissioner chooses not to stand on his own formal or detailed requirements, it would be making an empty abstraction, and not a practical safeguard, of a regulation to allow the Commissioner to invoke technical objections after he has investigated the merits of a claim and taken action upon it.

Rev. Rul. 54-17, supra, creates procedural requirements for the benefit of the Government that facilitate the administrative refund process, and it is incredible that those requirements can be raised against the Government when a rebate has been made to the appropriate party. Stauffer New Mexico, as the successor of Stauffer California, was procedurally entitled to assert and receive a "quickie"(tentative) refund of Stauffer California's taxes. And this petitioner affirms. Nor does petitioner dispute that the refund claim related to Stauffer California's taxes. It follows that since the basis of the refund

assets of Stauffer California and it assumed and agreed to pay all federal taxes "due and payable by * * * [Stauffer California] for the taxable year (or years) ended 1/31/58 and 1/31/59." (I-R. 200.) Thus, Stauffer New Mexico admitted its obligation as transferee for any deficiencies in the tax of Stauffer California for the years to which the carryback was claimed.

Mr. Stauffer's transferee liability for deficiencies in Stauffer California's taxes is also admitted.

In any event, it is not necessary for Stauffer New Mexico to be a "transferee." As Stauffer California's successor, it was liable for any deficiency in its predecessor's taxes, and such a deficiency arose on rebate of the taxes. Commissioner v. Newport Industries, Inc., 121 F. 2d 655 (C.A. 7th). Mr. Stauffer, on liquidation of Stauffer New Mexico, received its assets (and its predecessors') charged with the obligation to pay Stauffer California's tax deficiency which was also Stauffer New Mexico's obligation. Indeed, Mr. Stauffer, as trustee in liquidation of Stauffer New Mexico negotiated the refund checks totalling more than $1,750,000. (I-R. 199.) Petitioner's arguments are wholly without merit.

CONCLUSION

For the foregoing reasons, the decisions of the Tax Court should be affirmed.

Respectfully submitted,

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April, 1968.

CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19, and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

Dated: _______________ day of ____________________, 1968.

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APPENDIX

Internal Revenue Code of 1954:

SEC. 172. NET OPERATING LOSS DEDUCTION.

(a) Deduction Allowed.--There shall be allowed as a deduction for the taxable year an amount equal to the aggregate of (1) the net operating loss carryovers to such year, plus (2) the net operating loss carrybacks to such year. For purposes of this subtitle, the term "net operating loss deduction" means the deduction allowed by this subsection.

(b) [as amended by Sec. 317(b), Trade Expansion Act of 1962, P.L. 87-794, 76 Stat. 872] Net Operating Loss Carrybacks and Carryovers.--

(1) Years to which loss may be carried.--

(A)(i) Except as provided in clause (ii), a net operating loss for any taxable year ending after December 31, 1957, shall be a net operating loss carryback to each of the 3 taxable years preceding the taxable year of such loss.

* * *

(B) Except as provided in subparagraph (c), a net operating loss for any taxable year ending after December 31, 1955, shall be a net operating loss carryover to each of the 5 taxable years following the taxable year of such loss.

* * *

(2) Amount of carrybacks and carryovers.--Except as provided in subsections (i) and (j), the entire amount of the net operating loss for any taxable year (hereinafter in this section referred to as the 'loss year') shall be carried to the earliest of the taxable years to which (by reason of paragraph (1)) such loss may be carried. The portion of such loss which shall be carried to each of the other taxable years shall be the excess, if any, of the amount of such loss over the sum of the taxable income for each of the prior taxable years to which such loss may be carried. * * *

* * *

(c) Net operating Loss Defined.--For purposes of this section, the term "net operating loss" means (for any taxable year ending after December 31, 1953) the excess of the deductions allowed by this chapter over the gross income. Such excess shall be computed with the modifications specified in subsection (d).

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(26 U.S.C. 1964 ed., Sec. 172.)

SEC. 368. DEFINITIONS RELATING TO CORPORATE REORGANIZATIONS.

(a) Reorganization.--

(1) In General.--For purposes of parts I and II and this part, the term "reorganization" means--

(A) a statutory merger or consolidation;

(B) the acquisition by one corporation, in exchange solely for all or a part of its voting stock, of stock of another corporation if, immediately after the acquisition, the acquiring corporation has control of such other corporation (whether or not such acquiring corporation had control immediately before the acquisition);

(C) the acquisition by one corporation, in exchange solely for all or a part of its voting stock (or in exchange solely for all or a part of the voting stock of a corporation which is in control of the acquiring corporation), of substantially all of the properties of another corporation, but in determining whether the exchange is solely for stock the assumption by the acquiring corporation of a liability of the other, or the fact that property acquired is subject to a liability, shall be disregarded;

(D) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor, or one or more of its shareholders (including persons who were shareholders immediately before the transfer), or any combination thereof, is in control of the corporation to which the assets are transferred; but only if, in pursuance of the plan, stock or securities of the corporation to which the assets are transferred are distributed in a transaction which qualifies under section 354, 355, or 356;

(E) a recapitalization; or

(F) a mere change in identity, form, or place of organization, however effected.

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(26 U.S.C. 1964 ed., Sec. 368.)

SEC. 381. CARRYOVERS IN CERTAIN CORPORATE ACQUISITIONS.

(a) General Rule.--In the case of the acquisition of assets of a corporation by another corporation--

(1) in a distribution to such other corporation to which section 332 (relating to liquidations of subsidiaries) applies, except in a case in which the basis of the assets distributed is determined under section 334 (b) (2); or

(2) in a transfer to which section 361 (relating to nonrecognition of a gain or loss to corporations) applies, but only if the transfer is in connection with a reorganization described in subparagraph (A), (C), (D) (but only if the requirements of subparagraphs (A) and (B) of section 354 (b) (1) are met), or (F) of section 368 (a) (1),

the acquiring corporation shall succeed to and take into account, as of the close of the day of distribution or transfer, the items described in subsection (c) of the distributor or transferor corporation, subject to the conditions and limitations specified in subsections (b) and (c).

(b) Operating Rules.--Except in the case of an acquisition in connection with a reorganization described in subparagraph (F) of section 368 (a) (1)--

(1) The taxable year of the distributor or transferor corporation shall end on the date of distribution or transfer.

(2) For purposes of this section, the date of distribution or transfer shall be the day on which the distribution or transfer is completed; except that, under regulations prescribed by the Secretary or his delegate, the date when substantially all of the property has been distributed or transferred may be used if the distributor or transferor corporation ceases all operations, other than liquidating activities, after such date.

(3) The corporation acquiring property in a distribution or transfer described in subsection (a) shall not be entitled to carry back a net operating loss for a taxable year ending after the date of distribution or transfer to a taxable year of the distributor or transferor corporation.

(c) Items of the distributor or transferor corporation.--The items referred to in subsection (a) are:

(1) Net operating loss carryovers.--The net operating loss carryovers determined under section 172, subject to the following conditions and limitations:

(A) The taxable year of the acquiring corporation to which the net operating loss carryovers of the distributor or transferor corporation are first carried shall be the first taxable year ending after the date of distribution or transfer.

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(3) Capital loss carryover.--The capital loss carryover determined under section 1212, subject to the following conditions and limitations;

(A) The taxable year of the acquiring corporation to which the capital loss carryover of the distributor or transferor corporation is first carried shall be the first taxable year ending after the date of distribution or transfer.

* * *

(26 U.S.C. 1964 ed., Sec. 381.)

SEC. 6211. DEFINITION OF A DEFICIENCY.

(a) In General.--For purposes of this title in the case of income, estate, and gift taxes, imposed by subtitles A and B, the term "deficiency" means the amount by which the tax imposed by subtitles A or B exceeds the excess of--

(1) the sum of

(A) the amount shown as the tax by the taxpayer upon his return, if a return was made by the taxpayer and an amount was shown as the tax by the taxpayer thereon, plus

(B) the amounts previously assessed (or collected without assessment) as a deficiency, over--

(2) the amount of rebates, as defined in subsection (b) (2), made.

(b) Rules for application of subsection (a).--For purposes of this section--

* * *

(2) The term "rebate" means so much of an abatement, credit, refund, or other repayment, as was made on the ground that the tax imposed by subtitles A or B was less than the excess of the amount specified in subsection (a) (1) over the rebates previously made.

* * *

(26 U.S.C. 1964 ed., Sec. 6211.)

Treasury Regulations on Income Tax (1954 Code):

§ 1.381(a)-1 General rule relating to carryovers in certain corporate acquisitions.

* * *

(2) Acquiring corporation defined. (i) Only a single corporation may be an acquiring corporation for purposes of section 381 and the regulations thereunder. The corporation which acquires the assets of its subsidiary corporation in a complete liquidation to which section 381(a)(1) applies is the acquiring corporation for purposes of section 381. Generally, in a transaction to which section 381(a)(2) applies, the acquiring corporation is that corporation which, pursuant to the plan of reorganization, ultimately acquires, directly or indirectly, all of the assets transferred by the transferor corporation. If, in a transaction qualifying under section 381(a)(2), no one corporation ultimately acquires all of the assets transferred by the transferor corporation, that corporation which directly acquires the assets so transferred shall be the acquiring corporation for purposes of section 381 and the regulations thereunder, even though such corporation ultimately retains none of the assets so transferred. Whether a corporation has acquired all of the assets transferred by the transferor corporation is a question of fact to be determined on the basis of all the facts and circumstances.

* * *

(3) Transactions and items not covered by section 381. (i) Section 381 does not apply to partial liquidations, divisive reorganizations, or other transactions not described in subparagraph (1) of this paragraph. Moreover, section 381 does not apply to the carryover of an item or tax attribute not specified in subsection (c) thereof. In a case where section 381 does not apply to a transaction, item, or tax attribute by reason of either of the preceding sentences, no inference is to be drawn from the provisions of section 381 as to whether any item or tax attribute shall be taken into account by the successor corporation.

* * *

(26 C.F.R., Sec. 1.381(a)-1)

§ 1.381(b)-1 Operating rules applicable to carryovers in certain corporate acquisitions.

(a) Closing of taxable year--(1) In general. Except in the case of a reorganization qualifying under section 368(a)(1)(F), the taxable year of the distributor or transferor corporation shall end with the close of the date of distribution or transfer.

(2) Reorganizations under section 368(a)(1)(F). In the case of a reorganization qualifying under section 368(a)(1)(F) (whether or not such reorganization also qualifies under any other provision of section 368(a)(1)), the acquiring corporation shall be treated (for purposes of section 381) just as the transferor corporation would have been treated if there had been no reorganization. Thus, the taxable year of the transferor corporation shall not end on the date of transfer merely because of the transfer; a net operating loss of the acquiring corporation for any taxable year ending after the date of transfer shall be carried back in accordance with section 172(b) in computing the taxable income of the transferor corporation for a taxable year ending before the date of transfer; and the tax attributes of the transferor corporation enumerated in section 381(c) shall be taken into account by the acquiring corporation as if there had been no reorganization.

*   *   *

(c) Return of distributor or transferor corporation. The distributor or transferor corporation shall file an income tax return for the taxable year ending with the date of distribution or transfer described in paragraph (b) of this section. If the distributor or transferor corporation remains in existence after such date of distribution or transfer, it shall file an income tax return for the taxable year beginning on the day following the date of distribution or transfer and ending with the date on which the distributor or transferor corporation's taxable year would have ended if there had been no distribution or transfer.

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(26 C.F.R., Sec. 1.381(b)-1)

§ 1.381(c)(1)-1 Net operating loss carryovers in certain corporate acquisitions.

* * *

(b) Carryback of net operating losses. A net operating loss of the acquiring corporation for any taxable year ending after the date of distribution or transfer shall not be carried back in computing the taxable income of a distributor or transferor corporation. However, a net operating loss of the acquiring corporation for any such taxable year shall be carried back in accordance with section 172(b) in computing the taxable income of the acquiring corporation for a taxable year ending on or before the date of distribution or transfer. If a distributor or transferor corporation remains in existence after the date of distribution or transfer, a net operating loss sustained by it for any taxable year beginning after such date shall be carried back in accordance with section 172(b) in computing the taxable income of such corporation for a taxable year ending on or before that date, but may not be carried back or over in computing the taxable income of the acquiring corporation. This paragraph may be illustrated by the following examples:

Example (1). On December 31, 1954, X Corporation merged into Y Corporation in a statutory merger to which section 361 applies, and the charter of Y Corporation continued after the merger. Y Corporation sustained a net operating loss for the calendar year 1955. Y Corporation's net operating loss for 1955 may not be carried back in computing the taxable income of X Corporation but shall be carried back in computing the taxable income of Y Corporation.

Example (2). On December 31, 1954, X Corporation and Y Corporation transferred all their assets to Z Corporation in a statutory consolidation to which section 361 applies. Z Corporation sustained a net operating loss for the calendar year 1955. Z Corporation's net operating loss for 1955 may not be carried back in computing the taxable income of X Corporation or Y Corporation.

Example (3). On December 31, 1954, X Corporation ceased all operations (other than liquidating activities) and transferred substantially all its properties to Y Corporation in a reorganization qualifying under section 368(a)(1)(C). Such properties comprised all of X Corporation's properties which were to be transferred pursuant to the reorganization. In

the process of liquidating its assets and winding up its affairs, X Corporation sustained a net operating loss for its taxable year beginning on January 1, 1955. This net operating loss of X Corporation shall be carried back in computing the taxable income of that corporation but may not be carried back or over in computing the taxable income of Y Corporation.

* * *

(26 C.F.R., Sec. 1.381(c)(1)-1)

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